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NATIONAL
TEA CO.

ANNUAL REPORT 1963

EXECUTIVES—GENERAL OFFICE

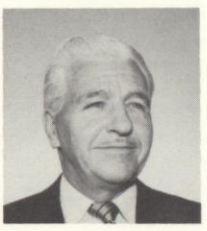
GEORGE C. METCALF
Chairman of the Company

NORMAN A. STEPELTON
President and
Chief Executive Officer

CLAUDE H. WEBSTER
Executive Vice President

NORBERT L. CHAPLICKI
Vice President
Meat Operations

ALLAN WILSON, JR.
Secretary—Treasurer



HAROLD L. WILKENS
Vice President
Produce Operations

JOHN E. O'BERRY
Vice President
Grocery Merchandiser

J. W. CHILCUTT
Advertising &
Sales Promotion

WILLIAM J. LEDERER
Vice President
General Counsel

E. C. WINLAND
Comptroller

J. P. QUIRK
Vice President
Labor Relations

J. E. COLLOTON
Warehouse & Transportation
Operations

national tea co.

directors

NORBERT L. CHAPLICKI
Vice President

JOHN F. CUNEO
President of
The Cuneo Press, Inc.

EDWARD L. JONES
Secretary of George Weston, Ltd.

HARLEY V. MCNAMARA
Consultant

RICHARD G. MEECH
Vice President, Secretary and Treasurer of Loblaw Groceterias Co., Ltd.

GEORGE C. METCALF
Chairman of the Company and President of Loblaw Groceterias, Co., Ltd.

NORMAN A. STEPELTON
President and Chief Executive Officer

CLAUDE H. WEBSTER
Executive Vice President

W. GARFIELD WESTON
Chairman of the Board of George Weston, Ltd.

officers

GEORGE C. METCALF
Chairman of the Company

NORMAN A. STEPELTON
President and Chief Executive Officer

CLAUDE H. WEBSTER
Executive Vice President

NORBERT L. CHAPLICKI
Vice President

GEORGE E. HOUSTON
Vice President

HENRY H. NIEMANN
Vice President

HAROLD L. WILKENS
Vice President

J. E. LAUGHLIN
Vice President

FRANK E. LINQUIST
Vice President

NAT MALT
Vice President

JOHN E. O'BERRY
Vice President

WILLIAM J. LEDERER
Vice President and General Counsel

J. P. QUIRK
Vice President

H. L. MARTIN
Vice President

ALLAN WILSON, JR.
Secretary-Treasurer

E. C. WINLAND
Comptroller

HOME OFFICE:

1000 N. CROSBY STREET

CHICAGO, ILLINOIS 60680

Divisional Offices and Warehouses

• CHICAGO • MINNEAPOLIS • MILWAUKEE
• INDIANAPOLIS • DETROIT • ST. LOUIS
• NEW ORLEANS • MEMPHIS • DAVENPORT
• DENVER • SIOUX CITY • YOUNGSTOWN

Food Stores Serving the States of

• ALABAMA • ARKANSAS • COLORADO
• ILLINOIS • INDIANA • IOWA • LOUISIANA
• MICHIGAN • MINNESOTA • MISSISSIPPI
• MISSOURI • NEBRASKA • NORTH DAKOTA
• OHIO • PENNSYLVANIA • SOUTH DAKOTA
• TENNESSEE • WEST VIRGINIA • WISCONSIN
• WYOMING

transfer agents

THE FIRST NATIONAL
BANK OF CHICAGO
Chicago, Illinois

THE CHASE MANHATTAN BANK
New York, New York

registrars

CONTINENTAL ILLINOIS NATIONAL
BANK & TRUST COMPANY OF CHICAGO
Chicago, Illinois

CHEMICAL BANK NEW YORK
TRUST COMPANY
New York, New York

transfer and paying agents

3½% Debentures
CHEMICAL BANK NEW YORK
TRUST COMPANY
New York, New York

5% Debentures
MORGAN GUARANTY TRUST COMPANY
New York, New York

EXECUTIVES—DIVISIONAL OPERATIONS

HENRY H. NIEMANN
Vice President
Regional Operations

GEORGE E. HOUSTON
Vice President
Regional Operations

H. L. MARTIN
Vice President
Personnel

J. E. LAUGHLIN
Vice President
Division Manager
Chicago

FRANK E. LINQUIST
Vice President
Division Manager
Denver

NAT MALT
Vice President
Division Manager
Youngstown

RODGERS N. BROWN
Division Manager
New Orleans

VICTOR M. PIEHLER
Division Manager
Minneapolis

ELMER E. MILLER
Division Manager
Indianapolis

WALTER L. KALM
Division Manager
Milwaukee

ROBERT O'NEAL
Division Manager
St. Louis

McLEED HITTSON
Division Manager
Detroit

JOHN J. FINLEY
Division Manager
Del Farm

MEL A. FRAISL
Division Manager
Davenport

DONALD R. O'NEIL
Division Manager
Sioux City

JESS GALLOWAY
Division Manager
Memphis

FRED C. BOYD
Division Manager
Sure Save

G. W. MAXWELL
Real Estate
Operations

financial highlights

for the 52 weeks ended	December 28, 1963	December 29, 1962	December 30, 1961	December 31, 1960	January 2, 1960
Sales	$1,056,919,339	$979,049,258	$888,852,905	$855,840,888	$829,518,276
Income before Federal income taxes	16,890,546	18,123,011	19,464,514	17,861,825	18,145,208
Federal income taxes	8,526,000	9,005,000	10,150,000	9,200,000	9,120,000
Special credit arising from sale of subsidiaries, net of taxes	840,710	—	—	—	—
Net income and special credit	9,205,256	9,118,011	9,314,514	8,661,825	9,025,208
Percent to sales	.87%	.93%	1.05%	1.01%	1.09%
Per share*	1.17	1.28	1.31	1.23	1.32
Dividends per share	.80	.80	.80	.80	.77
at year end					
Working capital	$ 57,425,117	$ 58,550,701	$ 42,422,922	$ 43,376,122	$ 43,954,849
Property and equipment	94,905,503	92,242,459	76,703,420	71,579,665	67,276,442
Long-term debt	32,531,023	33,607,132	29,628,922	31,104,000	32,070,000
Shareholders' investment	116,159,100	113,783,457	87,039,714	82,140,961	78,847,439
Shares outstanding	8,525,815	7,161,942	7,133,505	7,053,722	7,033,990
Book value per share	13.62	13.35	12.20	11.65	11.21
Supermarkets in operation	986	985	897	897	910

*Based upon average of number of shares outstanding at beginning and end of year.

president's letter

TO OUR SHAREHOLDERS:

In a number of respects, 1963 was a banner year for National Tea Co. From a single store with sales of $4.65 on the opening day in 1899, the Company has progressed to membership in the Billion Dollar Club. Sales totaled $1,056,919,-339, or an 8.0% increase over the prior year.

From the standpoint of earnings, 1963 was also a good year. Earnings were $9,205,256, compared with $9,118,011 for the previous year or a .96% increase. Earnings for 1963 include a non-recurring credit in the amount of $840,710. The management is encouraged with these results because, if anything, competition was more intensive and challenging than heretofore.

The perennial upward pressure of operating expenses remained with us in 1963, requiring installation of lower-cost methods wherever possible, expense control throughout the operation and more sales to offset the inevitable expense increase. In addition, competitive activity was extremely rugged in virtually every marketing area where the Company operates, with the result that profit margins were less than expected. For the first three quarters, earnings were reduced to .75% of sales. However, in the final quarter the rate of earnings to sales increased to 1.25%, a most encouraging trend.

It should be pointed out that 1963 total earnings after taxes, whatever the source, were the second highest in the history of the Company.

There were 986 supermarkets in operation at year end—a net increase of one store for the year. Also average annual sales increased to the highest record in the Company's history—$1,071,926 per store.

1963 earnings were equivalent to $1.17 per share based upon the average

number of shares outstanding during the year. On the same number of shares, earnings for 1962 would have been $1.16 per share.

The dividend record of the Company has continued without interruption and as you know, 80¢ per Common Share was paid to shareholders in 1963. After a meeting of the Board of Directors on January 27, 1964, announcement was made that the 78th consecutive quarterly dividend would be payable March 1, 1964,to shareholders of record February 14, 1964.

STORE AND WAREHOUSE IMPROVEMENTS

The Company continued its vigorous program of store and warehouse improvement in 1963. 68 modern supermarkets were opened—50 were new locations for the Company and 18 were relocations of older stores no longer suitable for the needs of the customers in those neighborhoods.

The year closed with a fine group of new locations under lease, which assures further internal growth for National in 1964. In keeping with the constantly rising investment required, we have continued to be extremely selective in choosing new locations.

We also modernized 45 existing stores having greater sales potential. Through our new store and improvement program, we endeavored to improve further our fine store image and to present the cleanest and most up-to-date supermarkets for the shopping pleasure of Mr. and Mrs. Consumer.

A total of 67 stores was closed during 1963, including 18 stores which were relocated. The balance of the locations closed were generally smaller stores where the sales and profit potentials were seriously reduced due to population shifts, changing neighborhoods, urban renewal programs, new expressways, and other such developments.

Substantial warehouse improvements were made during the year in three Divisions. A new commissary and freezer installation in the New Orleans Distribution Center completes our development there and brings together under one roof all warehousing activities in this completely new and exceptionally efficient plant, with plenty of room available for expansion later when needed. A new meat commissary and frozen food facility was constructed for the Chicago Division to keep pace with our increased volume of meat and frozen food sales. A new meat commissary was installed in the Youngstown warehouse to bring the cost and quality advantages of modern meat distribution to that Division. The costs of the New Orleans and Youngstown building improvements were borne by our lessors, with appropriate increases in rentals, while the Chicago facility is on Company-owned property.

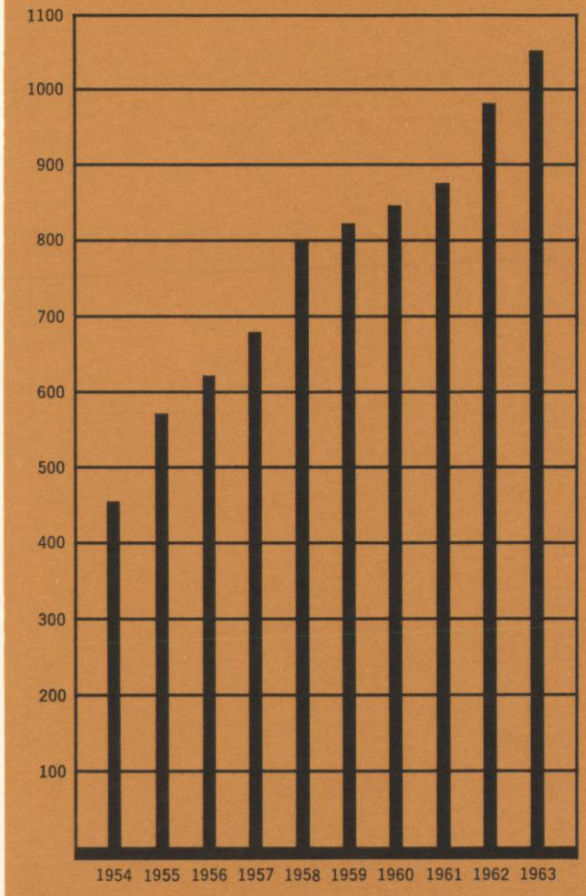
A total of $16,475,362 was expended for property and equipment additions during the year.

FINANCIAL POSITION

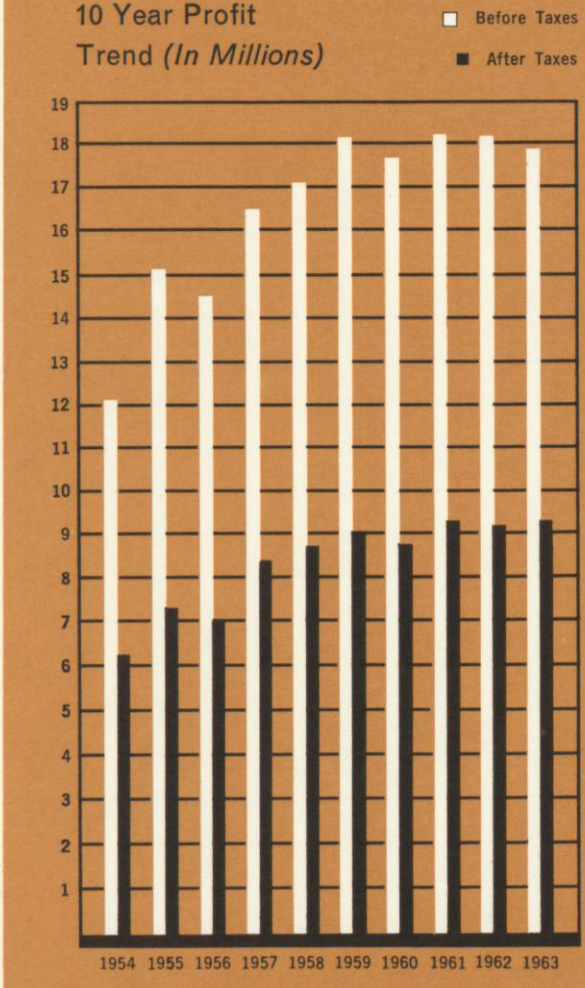
The Company was able to finance this growth in 1963 through funds generated internally, and no further borrowing was required except for short term notes issued to finance peak inventory requirements. As in 1962, all such short term borrowings were retired prior to year end.

Working capital declined slightly during the year, but the current ratio as defined under the indenture securing the 5% Sinking Fund Debentures was 2.3 to 1, well in excess of the required 2.0 to 1.

10 Years of
Record Sales *(In Millions)*



10 Year Profit
Trend *(In Millions)*



1963 distribution of the sales dollar

	%
Cost of Merchandise Sold	79.24
Wages & Benefits	12.11
Rents, Repairs & Depreciation	3.65
Other Expense	2.80
Taxes	1.33
Dividends	.64
Retained Earnings	.23
	100.00%

ORGANIZATIONAL CHANGES

We are constantly striving to improve the quality of leadership throughout the organization, and have made numerous changes toward this end during the year.

Mr. J. P. Quirk, a Company employee for 14 years, who has been in charge of Labor Relations, was elected a Vice President.

Mr. H. L. Martin, with 14 years of service, was elected Vice President in charge of Personnel.

Mr. F. E. Linquist, a Division Manager having 33 years of service with the Company, and Mr. N. Malt, a Division Manager having 34 years of experience in the retail food field, were elected Vice Presidents.

Mr. J. Galloway, with 35 years of experience in various positions from store clerk through Store Superintendent and Divisional Produce Operator, was promoted to Division Manager.

Mr. E. C. Winland, formerly Chicago Division Accountant, was elected Comptroller of the Company.

Numerous other promotions and transfers have been effected to place employees in positions where further training and experience will prepare them for increased responsibilities in the future and at the same time promote the growth of the Company.

The progress made by the Company in 1963 is the result of the teamwork of 27,000 employees working together in the stores, plants, warehouses, transportation operations and offices. The future success of the Company likewise depends upon the dedication and enthusiasm of these people. We have given a great deal of time and attention to the selection and training of our personnel and will continue to emphasize these activities in the future, for the Company can be no more than a reflection of its employees.

We should like to express our appreciation to all of our employees for their hard work and loyal support during the year. We know we can count upon their continued loyalty and cooperation in the year 1964 and in the future.

OUTLOOK

Many factors could affect the retail grocery field this year: the new tax laws, the presidential election, the international situation, and numerous others. While the economists and political scientists debate these matters, your management will content itself in evaluating those conditions within its own control.

Other than the tax reduction benefits which will be helpful to all business, we look to 1964 as a good year for a number of other reasons. Our business is dependent upon people; through new and more intensive training programs introduced in the past years, our store people have become more efficient and productive. Likewise supervision and store, office and warehouse management have been constantly upgraded by promotions from within the ranks. We believe that executive management, assisted by this fine organization, will bring the Company increased sales and profits.

For all of these reasons we say to you, the shareholder, we are genuinely optimistic over prospects for increased sales and earnings in 1964.

N. A. Stepelton

N. A. Stepelton
President

Chicago, Illinois,
February 7, 1964.

"DAWN DEW FRESH" FR

Of the many standards used in purchasing fresh fruits and vegetables, quality ranks first. It is this constant emphasis on quality that rates National's fresh fruits and vegetables as the finest, consistently deserving the title "Dawn Dew Fresh."

National buyers literally "follow the sun" to find the finest crops of fruits and vegetables at their peak of perfection. For example, our apple buyers range from Virginia to the great Northwest. Wherever a new crop is ripening, National buyers are "on the spot" to get first choice of the finest.

Timing is extremely important. The ripening of crops varies from season to season with the weather. Buying the best, at exactly the right time, and shipping immediately is absolutely essential for fresh fruits and vegetables to arrive at the stores "Dawn Dew Fresh."

Price must often be a secondary consideration in maintaining a real quality standard. "Dawn Dew Fresh" fruits and vegetables represent the first grade, ideal in shape and size, most appealing in appearance, and at their very peak of flavor and goodness. This is the quality the customer wants, and National insists on providing.

To maintain this "Dawn Dew Fresh" standard, National's buying operation is necessarily decentralized. Far flung field offices deal directly with the growers in widely scattered areas and climates. This results in the "3 F's" of successful purchasing: First-Hand Knowledge, Friendly Relations, and Flexibility.

First-Hand Knowledge enables the field office buyer to compare the quality of crops ripening in different areas, not from samples but by personal inspection. Based on this knowledge, he may decide, for instance, to purchase a different *type* of peach... or the *same type from another area*, in order to obtain the best quality available.

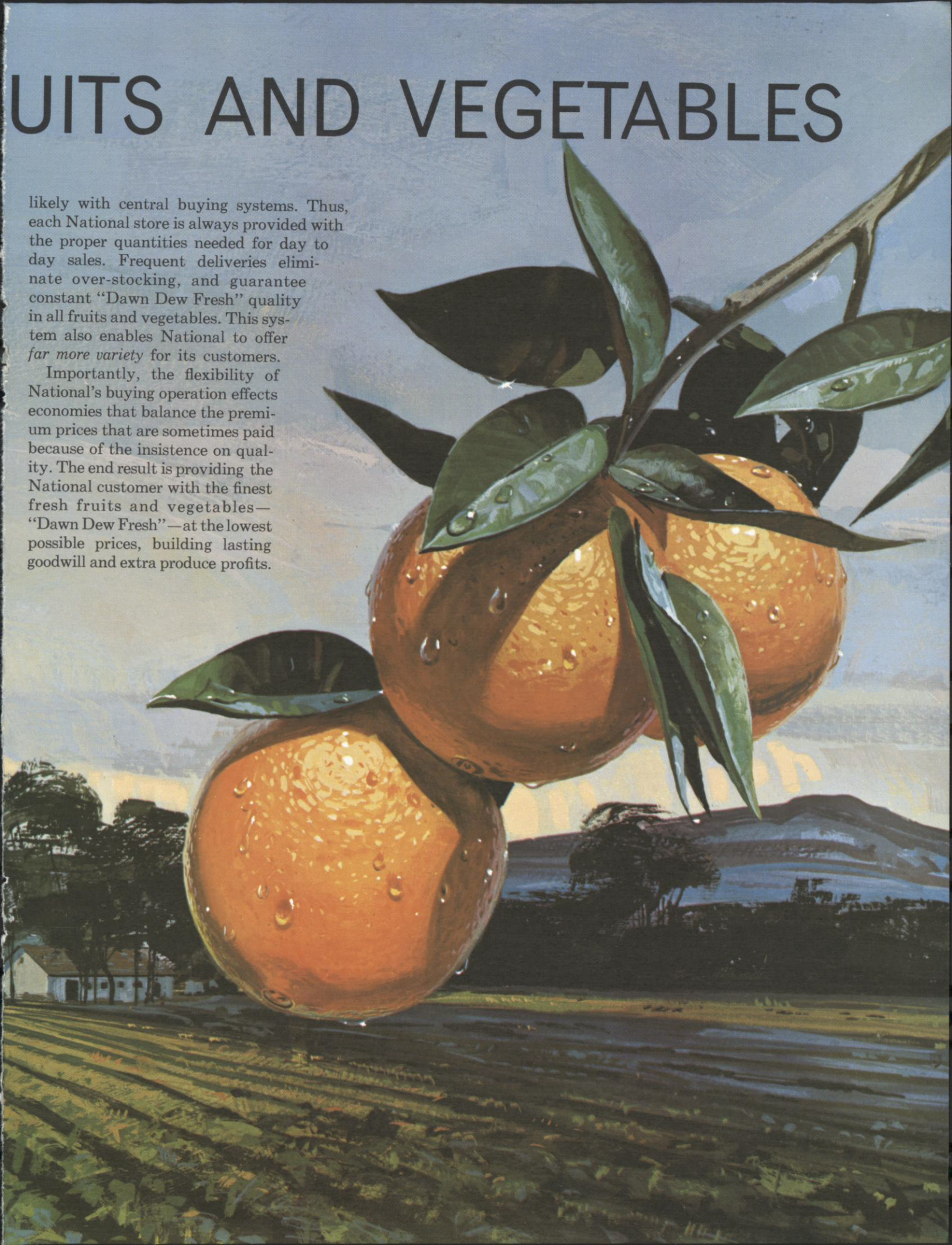
Friendly Relations naturally develop from such personal contact between the National buyer and grower, and are an incentive to "give the nod to National" when he has a limited supply of an unusually excellent crop.

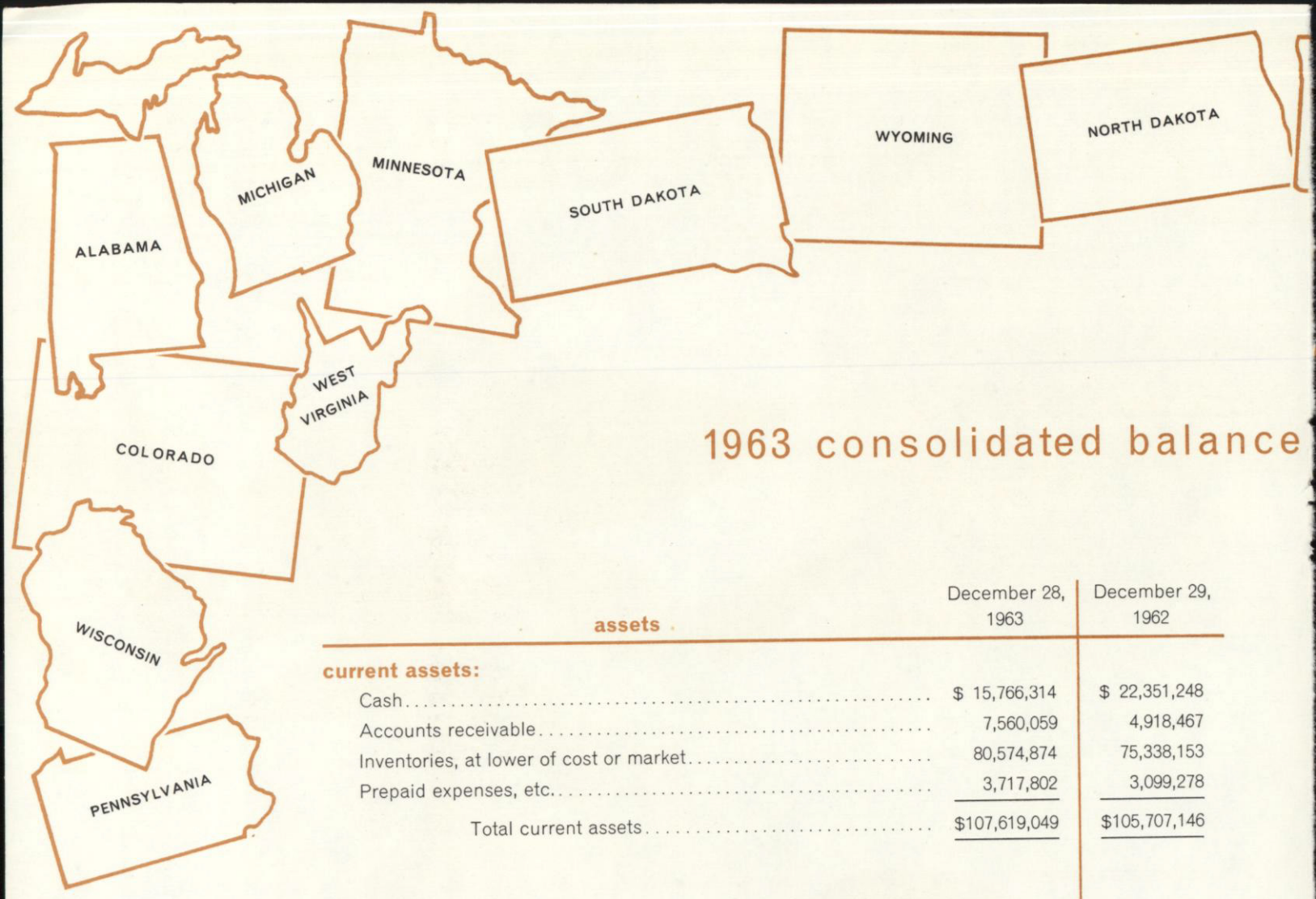
Flexibility means that each Division can order its fresh fruits and vegetables in *mixed truckloads*, which is un-

UITS AND VEGETABLES

likely with central buying systems. Thus, each National store is always provided with the proper quantities needed for day to day sales. Frequent deliveries eliminate over-stocking, and guarantee constant "Dawn Dew Fresh" quality in all fruits and vegetables. This system also enables National to offer *far more variety* for its customers.

Importantly, the flexibility of National's buying operation effects economies that balance the premium prices that are sometimes paid because of the insistence on quality. The end result is providing the National customer with the finest fresh fruits and vegetables—"Dawn Dew Fresh"—at the lowest possible prices, building lasting goodwill and extra produce profits.

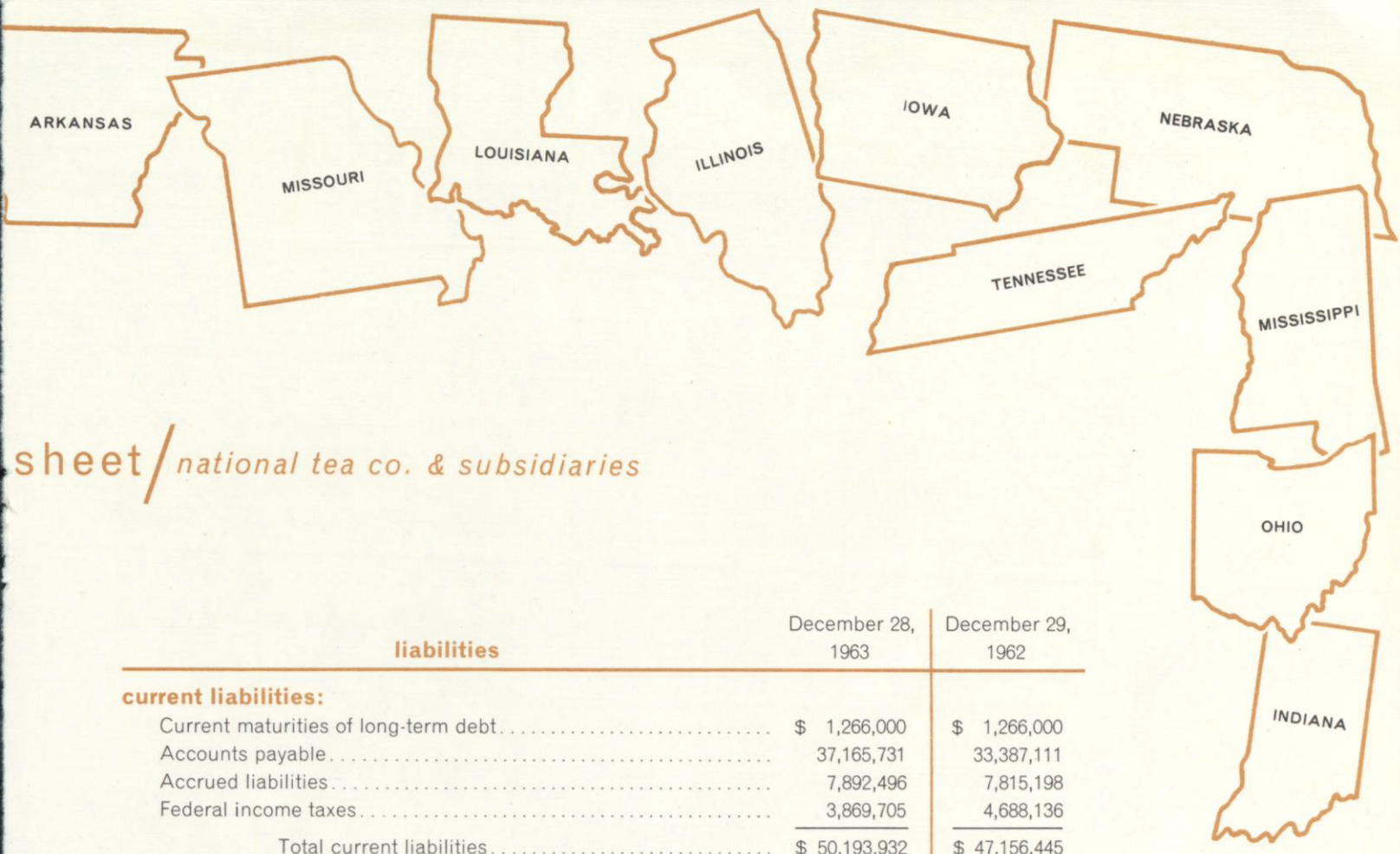




1963 consolidated balance

assets	December 28, 1963	December 29, 1962
current assets:		
Cash	$ 15,766,314	$ 22,351,248
Accounts receivable	7,560,059	4,918,467
Inventories, at lower of cost or market	80,574,874	75,338,153
Prepaid expenses, etc.	3,717,802	3,099,278
Total current assets	$107,619,049	$105,707,146
other assets	$ 2,261,503	$ 2,047,429
property and equipment, at cost:		
Land	$ 2,651,880	$ 2,673,828
Buildings	9,255,028	9,643,827
Fixtures and equipment	104,888,135	98,882,546
Reserves for depreciation	(46,318,566)	(41,739,740)
Leasehold improvements, less amortization	23,500,234	21,853,206
	$ 93,976,711	$ 91,313,667
Unamortized excess of cost of investment in divisions and subsidiaries over underlying book values at dates of acquisition	928,792	928,792
	$ 94,905,503	$ 92,242,459
	$204,786,055	$199,997,034

The accompanying notes are



sheet / *national tea co. & subsidiaries*

liabilities	December 28, 1963	December 29, 1962
current liabilities:		
Current maturities of long-term debt	$ 1,266,000	$ 1,266,000
Accounts payable	37,165,731	33,387,111
Accrued liabilities	7,892,496	7,815,198
Federal income taxes	3,869,705	4,688,136
Total current liabilities	$ 50,193,932	$ 47,156,445
long-term debt:		
Installment mortgage notes on store buildings	$ 972,023	$ 782,132
3½% promissory notes, due serially to 1969	430,000	516,000
4% promissory notes, due serially to 1973	10,800,000	11,500,000
5% sinking fund debentures, due 1977	9,120,000	9,600,000
4¾% term note, due 1967	5,000,000	5,000,000
3½% subordinated debentures, due 1980 (convertible into 324,230 common shares through 1965)	6,209,000	6,209,000
	$ 32,531,023	$ 33,607,132
other liabilities:		
Deferred Federal income taxes	$ 5,652,000	$ 5,200,000
Self-insurance	250,000	250,000
	$ 5,902,000	$ 5,450,000
shareholders' investment:		
3% subordinated promissory note exchanged for 1,362,963 common shares on February 11, 1963	$ —	$ 23,000,000
Common shares, $4 par value, authorized 10,000,000 shares; issued and outstanding 8,525,815 shares (7,161,942 in 1962)	34,103,260	28,647,768
Paid-in surplus	27,505,229	9,969,860
Earned surplus	54,550,611	52,165,829
	$116,159,100	$113,783,457
	$204,786,055	$199,997,034

an integral part of this statement.

statements of consolidated income and surplus

national tea co. & subsidiaries

income

	52 weeks ended December 28, 1963	52 weeks ended December 29, 1962
SALES	$1,056,919,339	$979,049,258
COSTS AND EXPENSES:		
Cost of sales and expenses	$1,005,652,539	$930,296,567
Depreciation and amortization	12,224,973	10,881,496
Rent	20,026,900	17,572,057
Interest	1,606,381	1,676,127
Profit sharing	518,000	500,000
Federal income taxes	8,526,000	9,005,000
	$1,048,554,793	$969,931,247
NET INCOME	$ 8,364,546	$ 9,118,011
SPECIAL CREDIT arising from sale of subsidiaries, net of Federal income taxes	840,710	—
NET INCOME AND SPECIAL CREDIT	$ 9,205,256	$ 9,118,011

earned surplus

BALANCE AT DECEMBER 29, 1962	$ 52,165,829
ADD (DEDUCT):	
Net income and special credit	9,205,256
Dividends ($.80 per share)	(6,820,474)
BALANCE AT DECEMBER 28, 1963	$ 54,550,611

paid-in surplus

BALANCE AT DECEMBER 29, 1962	$ 9,969,860
Excess of principal amount of long-term note over par value of common shares issued in conversion, net of new issue taxes	17,525,148
Excess of proceeds over par value of common shares sold to officers and employees under stock option plans	10,221
BALANCE AT DECEMBER 28, 1963	$ 27,505,229

The accompanying notes are an integral part of these statements.

consolidated statement of source and disposition of funds

	52 weeks ended December 28, 1963	December 29, 1962
source of funds:		
Net income and (in 1963) special credit	$ 9,205,256	$ 9,118,011
Non-cash items deducted in arriving at net income:		
Depreciation and amortization	12,224,973	10,881,496
Deferred Federal income taxes	452,000	351,000
Total funds from earnings and special credit	$21,882,229	$20,350,507
Issuance of 3% promissory note for the acquisition of the Youngstown Division	—	23,000,000
Proceeds from:		
4¾% term note	—	5,000,000
Mortgage loans on store buildings	230,000	280,000
Sale of common shares to optionees	13,861	348,709
Other sources, net	1,350,271	868,817
Total	$23,476,361	$49,848,033
disposition of funds:		
Cash dividends to shareholders	$ 6,820,474	$ 5,727,958
Net additions to property and equipment	16,475,362	26,695,506
Retirement of long-term debt	1,306,109	1,296,790
Increase or (decrease) in working capital	(1,125,584)	16,127,779
Total	$23,476,361	$49,848,033

notes to consolidated financial statements

long-term debt

Aggregate maturities and sinking fund requirements under long-term loan agreements, exclusive of minor installments due on store building mortgage loans are $1,266,000 for 1964, $1,566,000 for 1965 and 1966, $6,566,000 in 1967 and $1,566,000 in 1968.

dividend restriction

Under the terms of the indenture securing the 5% Sinking Fund Debentures, $25,721,728 of earned surplus is restricted as to the payment of cash dividends on and the purchase of common shares at December 28, 1963. In addition the company must maintain a current ratio of consolidated current assets to consolidated current liabilities as defined in the indenture of at least 2 to 1. As of December 28, 1963, the current ratio as defined was 2.3 to 1.

stock options

As of December 28, 1963, there were 11,680 unissued common shares reserved for employee stock options under the 1957 Plan. Each option expires five years after grant, but not later than January 1, 1966. 20% of the shares covered by each option becomes exercisable ten months after grant of the option and an additional 20% becomes exercisable each year thereafter.

As of December 28, 1963, there were 99,650 unissued common shares reserved for options under the 1959 Plan. Each option under this Plan as amended November 25, 1963, expires four years after date of grant, but not later than January 1, 1968. These options may be exercised in whole or in part at any time from eighteen months following the date of grant until expiration of the option.

Options for 48,600 shares granted May 4, 1959, at a price of $21.02 per share and still outstanding December 23, 1963, were modified, subject to shareholder ratification, to a price of $13.875, which was 100% of the closing price of the common shares on the New York Stock Exchange on the modification date.

Under both Plans, at December 28, 1963, options for 111,130 shares, of which 11,370 were exercisable, were outstanding at prices ranging from $13.875 to $21.02 per share.

Notes to consolidated financial statements (continued)

legal proceedings

In March, 1959, the Federal Trade Commission filed a complaint against the company alleging that several acquisitions of additional retail grocery stores violated Section 5 of the Federal Trade Commission Act and Section 7 of the Clayton Act. On April 8, 1963, the Hearing Examiner filed his initial decision dismissing the complaint. The matter is now on appeal to the full Commission. Nothing has occurred in the proceeding to date to indicate that there will be any adverse effect on the company as a result of this complaint.

As of December 28, 1963, four shareholder suits allegedly on behalf of the company had been filed against the company, all of the Directors in certain instances, Perrin Investments Limited, and others, seeking generally to set aside the transaction whereby the company acquired the stock of All American Stamp & Premium Corporation of New York. The suits do not ask for monetary damages against the company.

lease commitments

At December 28, 1963, the company and its subsidiaries had 772 leases expiring more than three years after that date (some of which contain percentage rental clauses) with minimum annual rentals amounting to approximately $17,800,000 exclusive of taxes, insurance and maintenance payable by the lessee. Of this amount, approximately 61% applies to leases expiring within 10 years.

ARTHUR ANDERSEN & CO.

120 SOUTH LA SALLE STREET
CHICAGO 3

TO THE SHAREHOLDERS,
NATIONAL TEA CO.:

We have examined the consolidated balance sheet of NATIONAL TEA CO. (an Illinois corporation) AND SUBSIDIARIES as of December 28, 1963, and the related statements of consolidated income and surplus and source and disposition of funds for the fifty-two weeks then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated balance sheet, statements of income and surplus and source and disposition of funds present fairly the financial position of National Tea Co. and Subsidiaries as of December 28, 1963, and the results of their operations and the sources and disposition of funds for the fifty-two weeks then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding fifty-two week period.

ARTHUR ANDERSEN & CO.

Chicago, Illinois,
February 7, 1964.

Maintaining a matchless reputation
National's "Corn Fed" Beef!
When it comes to beef, National brings you the best in quality, by featuring only genuine "Corn Fed Beef" from the best cattle feeding areas of the country. Corn feeding assures you of beef that is tender, well-marbled for full, delicious flavor. And, every piece is Value-Way Trimmed to give you more eating beef for your money.

NATIONAL
TEA CO.